3

Profit or Loss Pre and Post Incorporation

Learning Objectives

After studying this chapter, you will be able to:

- Understand the meaning of pre-incorporation profit or loss.
- Account for pre-incorporation profit or loss.
- Learn various methods for computing profit or loss prior to incorporation.

1. Introduction

When a running business is taken over by the promoters of a company, as at a date prior to the date of incorporation of company, the amount of profit or loss of such a business for the period prior to the date the company came into existence is referred to as pre-incorporation profits or losses. Such profits or losses, though belonging to the company or payable by it, are of capital nature; it is necessary to disclose them separately from trading profits or losses.

The general practice in this regard is that:

i. If there is a loss,

   a) it is either written off by debit to the Profit and Loss Account or to a special account described as "Loss Prior to Incorporation" and show as an "asset" in the Balance Sheet,

   b) Alternatively, it may be debited to the Goodwill Account.

ii. On the other hand, if a profit has been earned by business prior to the same being taken over and the same is not fully absorbed by any interest payable for the period, it is credited to Capital Reserve Account or to the Goodwill Account, if any goodwill has been adjusted as an asset. The profit will not be available for distribution as a dividend among the members of the company.

2. Methods of Computing Profit or Loss Prior to Incorporation

The determination of such profit or loss would be a simple matter if it is possible to close the books and take the stock held by the business before the company came into existence. In

such a case, the trial balance will be abstracted from the books and the profit or loss computed. Thereafter, the books will be either closed off or the balance allowed continuing undistributed; only the amount of profit or loss so determined being adjusted in the manner described above. When this is not possible, one or the other of the following methods will have to be followed for the purpose:

(1) The simplest, though not always the most expedient method is to close off old books and open new books with the assets and liabilities as they existed at the date of incorporation. In this way, automatically the result to that date will be adjusted, the difference between the values of assets and liabilities acquired and the purchase consideration being accounted for either as goodwill or as reserve.

The accounts, therefore, would relate exclusively to the post-incorporation period and any adjustment for the pre-incorporation period, whether an adjustment of profit or loss, would not be required.

(2) Since the decision to take over a business is usually reached long after the date from which it is agreed to be taken over it is normally not possible to follow any of the method aforementioned. The only alternative left, in the circumstances, is to split up the profit of the year of the transfer of the business to the company between ‘pre’ and ‘post’ incorporation periods. This is done either on the time basis or on the turnover basis or by a method which combines the two.

3. Basis of Apportionment

Item	***Basis of Apportionment between pre and Post incorporation period***
Gross Profit or Gross Loss	On the basis of turnover in the respective periods. Or On the basis of cost of goods sold in the respective periods in the absence of any information regarding turnover. Or On the basis of time in the respective periods in the absence of any information regarding turnover and cost of goods sold.
Variable expenses linked with Turnover [e.g. Carriage/Cartage outward, Selling and distribution expenses, Commission to selling agents/travelling agents, advertisement expenses, Bad debts (if actual bad debts for the two periods are not given), Brokerage, Sales Promotion.]	On the basis of Turnover in the pre and post incorporation.

Fixed Common charges [e.g. Salaries, Office and Administration Expenses, Rent, Rates and Taxes, Printing and Stationery, Telephone, Telegram and Postage, Depreciation, Miscellaneous Expenses]	On the basis of Time in the pre and post incorporation periods.
Expenses exclusively relating to pre-Incorporation period [e.g. Interest on Vendor's Capital]	Charge to pre-incorporation period but if the purchase consideration is not paid on taking over of business, interest for the subsequent period is charged to post incorporation period.
Expenses exclusively relating to post-incorporation period [e.g. Formation expenses, interest on debentures, director's fees, Directors' remuneration, Preliminary Expenses, Share issue Expenses, Underwriting commission, Discount on issue of securities.	Charge to Post-incorporation period
Audit Fees (i) For Company's Audit under the Companies Act. (ii) For Tax Audit under section 44AB of the Income tax Act, 1961	 Charge to Post-incorporation period On the basis of turnover in the respective periods.
Interest on purchase consideration to vendor: (i) For the period from the date of acquisition of business to date of incorporation. (ii) For the period from the date	 Charge to Pre-incorporation period Charge to Post-incorporation period

Let us take a small example for better understanding of apportionment on the basis of time ratio and sales ratio.

Example

Lion Ltd. was incorporated on 1.8.2014 to take over the running business of M/s Happy with assets from 1.4.2014. The accounts of the company were closed on 31.3.2015.

The average monthly sales during the first four months of the year (2014-15) was twice the average monthly sales during each of the remaining eight months.

Calculate time ratio and sales ratio for pre and post incorporation periods.

Solution

Time ratio:

Pre-incorporation period (1.4.2014 to 1.8.2015)	= 4 months
Post incorporation period (1.8.2015 to 31.3.2015)	= 8 months
Time ratio	= 4 : 8 or 1 : 2

Sales ratio:

Average monthly sale before incorporation was twice the average sale per month of the post incorporation period. If weightage for each post-incorporation month is x, then

Weighted sales ratio = 4 × 2x : 8 × 1x = 8x : 8x or 1 : 1

4. Pre-incorporation Profits & Losses

S. No	Pre-incorporation Profits	Pre-incorporation Losses
1.	It is transferred to **Capital Reserve Account** (i.e. capitalized).	It is treated as a part of **business acquisition cost** (Goodwill).
2.	It can be used for : • writing off Goodwill on acquisition • writing off Preliminary Expenses • writing down over-valued assets • issuing of bonus shares • paying up partly paid shares	It can be used for : • setting off against Post-incorporation Profit • addition to Goodwill on acquisition • writing off Capital Profit

Illustration 1

Bidyut Limited was incorporated on 1st July, 2014 to acquire from Bijli as and from 1st January, the individual business carried on by him. The purchase price of the fixed assets and goodwill was agreed to be the sum equal to 80% of the profits made each year on ascertainment of the sum due.

The following Trial Balance as on 31st Dec., 2014 is presented to you to enable you to prepare a Balance Sheet as at that date.

	Dr.	*Cr.*
	₹	₹
Share Capital - 1,500 equity shares of		
₹ 100 each, ₹ 80 paid up		*1,20,000*
Trade receivables	*82,000*	
Inventory on 31st Dec., 2014	*67,000*	
Cash at bank and on hand	*24,000*	

Directors' fee	*3,000*	
Preliminary expenses	*24,000*	
Trade Payables		*32,000*
Net Profit for the year after providing for all expenses under agreement entered into with Bijli		*48,000*
	2,00,000	*2,00,000*

Solution

Balance Sheet of M/s Bidyut Ltd. as on 31st Dec., 2014

	Particulars	Notes	₹
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	1,20,000
b	Reserves and Surplus	2	21,000
2	**Current liabilities**		
a	Trade Payables		32,000
b	Other Current liabilities		38,400
	Total		**2,11,400**
	Assets		
1	**Non-current assets**		
a	Fixed assets	3	38,400
2	**Current assets**		
a	Inventories		67,000
b	Trade receivables		82,000
c	Cash and cash equivalents		24,000
	Total		**2,11,400**

Notes to accounts

	₹
1 Share Capital	
Equity share capital	
Issued & Subscribed Capital	
1,500 Equity Shares of ₹ 100 each, ₹ 80 paid up	1,20,000

2.	**Reserves and Surplus**			
	Capital Reserve (Pre incorporation profit)			24,000
	Profit and loss Account			
	Net Profit for the Year		24,000	
	Less: Directors' fee	3,000		
	Preliminary Expenses*	24,000	(27,000)	(3,000)
			Total	21,000
3.	**Fixed assets**			
	Goodwill and fixed assets (WN)			38,400

Working Note

	₹
Amount Payable to Bijli:	
Profit for the year	48,000
80% due as cost of goodwill, assets, etc.	38,400

Illustration 2

Inder and Vishnu, working in partnership registered a joint stock company under the name of Fellow Travellers Ltd. on May 31, 2014 to take over their existing business. It was agreed that they would take over the assets of the partnership for a sum of ₹ 3,00,000 as from January 1st, 2014 and that until the amount was discharged they would pay interest on the amount at the rate of 6% per annum. The amount was paid on June 30, 2014. To discharge the purchase consideration, the company issued 20,000 equity shares of ₹ 10 each at a premium of ₹ 1 each and allotted 7% Debentures of the face value of ₹ 1,50,000 to the vendors at par.

The summarized Profit and Loss Account of the "Fellow Travellers Ltd." for the year ended 31st December, 2014 was as follows :

	₹		₹
To Purchase, including Inventory	*1,40,000*	*By Sales:*	
To Freight and carriage	*5,000*	*1st January to 31st May 2014*	*60,000*
To Gross Profit c/d	*60,000*	*1st June to 31st Dec., 2014*	*1,20,000*
		By Inventory in hand	*25,000*
	2,05,000		*2,05,000*
To Salaries and Wages	*10,000*	*By Gross profit b/d*	*60,000*

* As per para 56 of AS 26, "Intangible Assets" preliminary expenses should be charged fully to the statement of profit and loss of the year in which it is incurred. However this standard will be discussed in detail in Paper - 5: Advanced Accounting.

To Debenture Interest	*5,250*		
To Depreciation	*1,000*		
To Interest on purchase Consideration (up to 30-6-2014)	*9,000*		
To Selling commission	*9,000*		
To Directors' Fee	*600*		
To Preliminary expenses	*900*		
To Provision for taxes	*6,000*		
To Dividend on equity shares @ 5%	*5,000*		
To Balance c/d	*13,250*		
	60,000		*60,000*

Prepare statement apportioning the expenses and calculate profits/losses for the 'post' and 'pre-incorporation' periods and also show how these figures would appear in the Balance Sheet of the company.

Solution

Fellow Travellers Ltd.

Statement showing calculation of profit /losses for pre and post incorporation periods

		Ratio	*Pre-incorporation*	*Post-incorporation*
Gross profit allocated on the basis of sale		1:2	20,000	40,000
Less: Administrative Expenses allocated				
On time basis:				
(*i*) Salaries and wages	10,000			
(*ii*) Depreciation	1,000			
	11,000	5:7	4,583	6,417
Selling Commission on the basis of sales		1:2	3,000	6,000
Interest on Purchase Consideration (Time basis)		5:1	7,500	1,500
Expenses applicable wholly to the Post-incorporation period:				
Debenture Interest	5,250			
Director's Fee	600			5,850
Preliminary expenses				900
Balance c/d to Balance Sheet			4,917	19,333

Fellow Travellers Ltd.
Extract from the Balance Sheet as on 31st Dec., 2014

	Particulars	*Notes*	₹
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	2,00,000
b	Reserves and Surplus	2	33,250
2	**Non-current liabilities**		
a	Long-term borrowings	3	1,50,000
3	**Current liabilities**		
a	Short term provisions	4	6,000
	Total		3,89,250

Notes to accounts

			₹
1.	**Share Capital**		
	20,000 equity shares of ₹ 10 each fully paid		2,00,000
2.	**Reserves and Surplus**		
	Profit Prior to Incorporation		4,917
	Securities Premium Account		20,000
	Profit and loss Account	19,333	
	Less: Provision for Tax†	(6,000)	
	Dividend on equity share‡	(5,000)	8,333
	Total		33,250
3.	**Long term borrowings**		
	Secured		
	7% Debentures		1,50,000
4.	**Other Current liabilities**		
	Provision for Taxes		6,000

† The entire amount of provision for tax has been considered to be related with company.
‡ It is assumed that dividend has already been paid.

Illustration 3

The partners of Maitri Agencies decided to convert the partnership into a private limited company called MA (P) Ltd. with effect from 1st January, 2014. The consideration was agreed at ₹ 1,17,00,000 based on the firm's Balance Sheet as at 31st December, 2013. However, due to some procedural difficulties, the company could be incorporated only on 1st April, 2014. Meanwhile the business was continued on behalf of the company and the consideration was settled on that day with interest at 12% per annum. The same books of account were continued by the company which closed its account for the first time on 31st March, 2015 and prepared the following summarized profit and loss account.

			₹
Sales			*2,34,00,000*
Less:	*Cost of goods sold*	*1,63,80,000*	
	Salaries	*11,70,000*	
	Depreciation	*1,80,000*	
	Advertisement	*7,02,000*	
	Discounts	*11,70,000*	
	Managing Director's remuneration	*90,000*	
	Miscellaneous office expenses	*1,20,000*	
	Office-cum-show room rent	*7,20,000*	
	Interest	*9,51,000*	*2,14,83,000*
Profit			*19,17,000*

The company's only borrowing was a loan of ₹ 50,00,000 at 12% p.a. to pay the purchase consideration due to the firm and for working capital requirements.

The company was able to double the average monthly sales of the firm, from 1st April, 2014 but the salaries trebled from that date. It had to occupy additional space from 1st July, 2014 for which rent was ₹ 30,000 per month.

Prepare statement of apportioning cost and revenue between pre-incorporation and post-incorporation periods and calculation of profits/losses for such periods. Also, suggest how the pre-incorporation profits are to be dealt with.

Solution

MA (P) Ltd.

Statement showing calculation of profit/losses for pre and post incorporation periods

		Pre-inc.	*Post-inc.*
		₹	₹
Sales		26,00,000	2,08,00,000
Less:	Cost of goods sold	18,20,000	1,45,60,000
	Salaries	90,000	10,80,000
	Depreciation	36,000	1,44,000
	Advertisement	78,000	6,24,000
	Discounts	1,30,000	10,40,000
	M.D.'s remuneration	—	90,000
	Misc. Office Expenses	24,000	96,000
	Rent	90,000	6,30,000
	Interest	3,51,000	6,00,000
Net Profit/(Loss)		(19,000)	19,36,000

Working Notes:

(1) Calculation of ratio of sales:

Let the average sales per month in pre-incorporation period be x. Then the average sales in post-inc. period are 2x. Thus total sales are $(3 \times x) + (12 \times 2x)$ or $27x$. Ratio of sales will be $3x : 24x$ or 1:8.

Time ratio is 3 months : 12 months or 1:4

(2) Expenses apportioned on turnover ratio basis are cost of goods sold, advertisement, discounts.

(3) Expenses apportioned on time ratio basis are Depreciation, and misc. office expenses.

(4) Ratio for apportionment of Salaries:

If pre-incorporation monthly average is x, for 3 months 3x.

Average for balance 12 months 3x, for 12 months 36x.

Hence ratio for division, 1:12.

(5) Apportionment of Rent:

		₹
Total Rent		7,20,000
Additional rent for 9 months (From 1st July 2014 to 31st March, 2015)		(2,70,000)
Rent for old premises for 15 months at ₹ 30,000 p.m.		4,50,000
	Pre-inc.	Post-inc.
Old Premises	90,000	3,60,000
Additional rent	—	2,70,000
	90,000	6,30,000

Note on treatment

Since the profits prior to incorporation are in the negative, they would:

(*a*) Either be considered as a reduction from any capital reserve accruing in relation to the transaction, or

(*b*) Be treated as goodwill.

Illustration 4

ABC Ltd. was incorporated on 1.5.2014 to take over the business of DEF and Co. from 1.1.2014. The summarised Profit and Loss Account as given by ABC Ltd. for the year ending 31.12.2014 is as under:

Summarised Profit and Loss Account

	₹		₹
To Rent and Taxes	*90,000*	*By Gross Profit*	*10,64,000*
To Salaries including manager's salary of ₹ 85,000	*3,31,000*	*By Interest on Investments*	*36,000*
To Carriage Outwards	*14,000*		
To Printing and Stationery	*18,000*		
To Interest on Debentures	*25,000*		
To Sales Commission	*30,800*		
To Bad Debts (related to sales)	*91,000*		
To Underwriting Commission	*26,000*		
To Preliminary Expenses	*28,000*		
To Audit Fees	*45,000*		
To Loss on Sale of Investments	*11,200*		
To Net Profit	*3,90,000*		
	11,00,000		*11,00,000*

Prepare a Statement showing allocation of expenses and calculations of pre-incorporation and post-incorporation profits after considering the following information:

(i) G.P. ratio was constant throughout the year.

(ii) Sales for January and October were 1½ times the average monthly sales while sales for December were twice the average monthly sales.

(iii) Bad Debts are shown after adjusting a recovery of ₹ 7,000 of Bad Debt for a sale made in July, 2011.

(iv) Manager's salary was increased by ₹ 2,000 p.m. from 1.5.2014.

(v) All investments were sold in April, 2014.

(vi) The entire audit fees relates to company.

Solution

Pre-incorporation period is for four months, from 1st January, 2014 to 30th April, 2014. 8 months' period (from 1st May, 2014 to 31st December, 2014) is post-incorporation period.

Statement showing calculation of profit/losses for pre and post incorporation periods

	Pre-Inc ₹	*Post inc* ₹
Gross Profit	3,42,000	7,22,000
Interest on Investments	36,000	–
Bad debts Recovery	7,000	–
	3,85,000	7,22,000
Less : Rent and Taxes	30,000	60,000
Salaries		
Manager's salary	23,000	62,000
Other salaries	82,000	1,64,000
Printing and stationery	6,000	12,000
Audit fees	-	45,000
Carriage outwards	4,500	9,500
Sales commission	9,900	20,900
Bad Debts (91,000 + 7,000)	31,500	66,500
Interest on Debentures	–	25,000
Underwriting Commission	–	26,000
Preliminary expenses	–	28,000
Loss on sale of investments	11,200	–
Net Profit	1,86,900*	2,03,100

* Pre-incorporation profit is a capital profit and will be transferred to Capital Reserve.

Working Notes:

(i) Calculation of ratio of Sales

Let average monthly sales be *x*.

Thus Sales from January to April are 4½ *x* and sales from May to December are 9½ *x*.

Sales are in the ratio of 9/2*x* : 19/2*x* or 9 : 19.

(ii) Gross profit, carriage outwards, sales commission and bad debts written off have been allocated in pre and post incorporation periods in the ratio of Sales i.e. 9 : 19.

(iii) Rent, salaries, printing and stationery, audit fees are allocated on time basis.

(iv) Interest on debentures, underwriting commission and preliminary expenses are allocated in post incorporation period.

(v) Interest on investments, loss on sale of investments and bad debt recovery are allocated in pre-incorporation period.

Illustration 5

A company was incorporated on 1st July, 2014 to take over the business of Mr. M as and from 1st April, 2014. Mr. M's summarised Balance Sheet, as at that date was as under:

Liabilities	*₹*	*Assets*	*₹*
Trade Payables	*36,000*	*Building*	*80,000*
Capital	*1,94,000*	*Furniture and Fittings*	*10,000*
		Trade receivables	*90,000*
		Inventory	*30,000*
		Bank	*20,000*
	2,30,000		*2,30,000*

Trade receivables and Bank balances are to be retained by the vendor and Trade payables are to be paid off by him. Realisation of trade receivables will be made by the company on a commission of 5% on cash collected. The company is to issue M with 10,000 equity shares of ₹ 10 each, ₹ 8 per share paid up and cash of ₹ 56,000.

The company issued to the public for cash 20,000 equity shares of ₹ 10 each on which by 31st March, 2015 ₹ 8 per share was called and paid up except in the case of 1,000 shares on which the third call of ₹ 2 per share had not been realized. In the case of 2,000 shares, the entire face value of the shares had been realized. The share issue was underwritten for 2% commission, payable in shares fully paid up.

In addition to the balances arising out of the above, the following were shown by the books of accounts of the company on 31st March, 2015:

	₹
Discount (including ₹ 1,000 allowed on vendor's receivables)	*6,000*
Preliminary expenses	*10,000*
Directors' fee	*12,000*
Salaries	*48,000*
Trade receivables (including vendor's receivables)	*1,60,000*
Trade Payables	*48,000*
Purchases	*3,20,000*
Sales	*4,60,000*

Inventory on 31st March, 2015 was ₹ 52,000. Depreciation at 10% on Furniture and Fittings and at 5% on Building is to be provided. Collections from trade receivables belonging to the vendor were ₹ 60,000 in the period.

Prepare a Statement showing apportionment of expenses and calculation of profits for pre and post incorporation periods and balance sheet as on 31-3-2015.

Solution

Calculation of Gross Profit

		₹
Sales		4,60,000
Closing inventory		52,000
		5,12,000
Less: Opening inventory		30,000
Purchases		3,20,000
Gross Profit		1,62,000

Statement showing Calculation of profit/losses for pre and post incorporation periods

	Pre-Incorporation ₹	*Post-Incorporation* ₹
Gross Profit	40,500	1,21,500
Commission	-	3,000
	40,500	1,24,500
Less: Salaries	12,000	36,000
Directors' fee	-	12,000
Discount	1,250	3,750
Depreciation:		
Building	1,000	3,000

Furniture	250	750
Preliminary expenses*		10,000
Pre-incorporation Profit transferred to Capital Reserve Account	26,000	-
Net Profit	-	59,000

Note: Apportionment of expenses has been made in the Statement showing Profit and Loss for pre-incorporation and post-incorporation period using the following basis:

Item	*Base*	*Ratio*
Gross Profit	Time	1 : 3
Salaries	Time	1 : 3
Discount	Time	1 : 3
Directors' Fees		100% to post-incorporation period
Commission		100% to post-incorporation period

Balance Sheet as on 31.3.2015

	Particulars	*Notes*	₹
	Equity and Liabilities		
1	**Shareholders' funds**		
a	Share capital	1	2,42,000
b	Reserves and Surplus	2	69,000
2	**Current liabilities**		
a	Trade Payables	3	48,000
B	Other liabilities	4	4,000
	Total		**3,63,000**
	Assets		
1	**Non-current assets**		
a	Fixed assets		
	Tangible assets	5	85,000
2	**Current assets**		
a	Inventories		52,000
b	Trade receivables		1,31,000
c	Cash and cash equivalents		91,000
d	Other current assets	6	4,000
	Total		**3,63,000**

* As per para 56 of AS 26, preliminary expenses do not appear in the balance sheet.

Notes to accounts

			₹
1.	**Share Capital**		
	Equity share capital		
	30,000 equity shares of ₹ 10 each ₹ 8 called-up	2,40,000	
	(of the above 10,000 shares are allotted pursuant to a contract without payments being received in cash)		
	Less: Calls in Arrear	(2,000)	2,38,000
	Share Suspense A/c (400 shares to be issued to the underwriter in consideration of under-writing commission on completion of share issue)		4,000
	Total		**2,42,000**
2.	**Reserves and Surplus**		
	Capital reserve	26,000	
	Less: Goodwill written off	(16,000)	10,000
	Profit and loss Account		59,000
	Total		**69,000**
3.	**Trade payables**		48,000
4.	**Other current liabilities**		
	Calls in advance		4,000
5.	**Fixed assets**		
	Building	80,000	
	Less: Depreciation	(4,000)	76,000
	Furniture & Fittings	10,000	
	Less: Depreciation	(1,000)	9,000
	Total		**85,000**
6.	**Other current assets**		
	Underwriting Commission		4,000

Working Notes:

(1)	**Goodwill on acquisition**	₹	₹
	Purchase consideration:		
	10,000 equity shares of ₹ 10 each, ₹ 8 paid up		80,000
	Cash		56,000
			1,36,000
	Less: Assets taken over		
	Building	80,000	

	Furniture and Fittings	10,000	
	Inventory	30,000	(1,20,000)
	Goodwill		16,000
(2)	**Cash Inflows from public issue of equity shares**		₹
	20,000 equity shares of ₹ 10 each ₹ 8 called up		1,60,000
	Less: Calls in arrear on 1,000 shares @ ₹ 2 per share		(2,000)
			1,58,000
	Add: Calls-in-advance on 2000 shares @ ₹ 2		4,000
			1,62,000
(3)	**Underwriting Commission 2% on face value ₹ 2,00,000**		4,000

Underwriting Commission becomes due on completion of the job relating to shares underwritten. It appears that the job relating to public issue was not finished till 31st March, 2015. So a Share Suspense Account should be created showing the amount of shares to be issued to the underwriter in discharge of his claim for commission

(4) Cash collection from Company's receivables

Total Trade receivables Account

	Vendor's receivables	*Company's receivables*		*Vendor's receivables*	*Company's receivables*
	₹	₹		₹	₹
To Balance b/d	90,000	-	By Discount	1,000	5,000
To Sales		4,60,000[§]	By Cash	60,000	3,24,000[**]
			By Balance c/d	29,000	1,31,000[††]
	90,000	4,60,000		90,000	4,60,000

(5) Cash payment for purchases

Total Trade payables Account			
	₹		₹
To Cash (Balancing figure)	2,72,000	By Purchases	3,20,000[‡‡]
To Balance c/d	48,000		
	3,20,000		3,20,000

[§] Assumed that all sales were on credit.
[**] Balancing figure.
[††] Total Trade receivables ₹ 1,60,000 minus Vendor's receivables ₹ 29,000.
[‡‡] Assumed that all purchases were on credit.

(6) **Summary Cash Book**

		₹			₹
To	Share Capital A/c	1,62,000	By	Total Trade Payables A/c	
To	Total Trade receivables A/c:			Payment to trade payables	2,72,000
	Collection from		By	Vendor's A/c:	
	company's receivables	3,24,000		Purchase consideration	56,000
	Collection from		By	Preliminary expenses	10,000
	vendor's receivables	60,000	By	Directors' Fee	12,000
			By	Salaries	48,000
			By	Vendor's A/c	
				(Collection less commission	
				₹ 3,000)	57,000
			By	Balance c/d	91,000
		5,46,000			5,46,000

5. Trade receivables and Trade Payables Suspense Accounts

As mentioned already, a company taking over a running business may also agree to collect its debts as an agent for the vendors and may further undertake to pay the trade payables on behalf of the vendors. In such a case, the trade receivables and trade payables of the vendors will be included in the accounts for the company by debit or credit to separate Total Accounts in the General Ledger to distinguish them from the trade receivables and trade payables of the business and contra entries will be made in corresponding Suspense Accounts. Also details of trade receivables' and trade payables' balance will be kept in separate ledgers. In order that the collections from trade receivables and payments of trade payables of vendors may not get mixed up with those of the company, it is a desirable procedure further to distinguish them by having separate columns for them in the Cash Book.

The book entries that should be passed for trade receivables in such a case are shown below:

1.	Debit Trade receivables A/c (or Total Debtors A/c) Credit trade receivables' Suspense A/c	for opening balance
2.	Debit Cash A/c	for cash received from trade receivables
	Debit Trade Receivables' Suspense A/c	for allowance etc. to trade receivables
	Credit Trade Receivables A/c	for cash and allowance etc.
3.	Debit Trade Receivables' Suspense A/c Credit Vendor A/c	for cash received from trade receivables for payable to vendors.

The vendor is thus treated as a trade payables for the cash received by the purchasing company in respect of the debts due to the vendor, just as if he has himself collected cash from his trade receivables and remitted the proceeds to the purchasing company.

For entries in respect of trade payables, the reverse of those outlined in respect of trade receivables will be passed. The vendor is considered a trade receivables in respect of cash paid to his trade payables by the purchasing company. The balance of the cash collected, less paid, will represent the amount due to or by the vendor, arising from trade receivables and trade payables' balances which have been taken over, subject to any collection expenses. The balance in the suspense accounts will be always equal to the amount of trade receivables and trade payables taken over remaining unadjusted at any time.

Illustration 6

Messrs. X, Y & Z, the balance sheet of whose business is given below transferred their business to a limited company with the same name on January 1, 2015. It was agreed that the company would take over the assets except cash and book debts at their book values, would pay ₹ 20,000 for the goodwill of business and would collect the book debts at a commission of 5%. Out of the collection from the trade receivables, the liabilities to trade payables would be first discharged as and when the amount is available, and the balance, if any, would be paid to vendors after six months. The partners undertook to pay off bank overdraft.

You are required to show the computation of the purchase consideration and the Vendors Collection Account, assuming that only ₹ 65,000 colected out of trade receivables*' balance and the remaining* trade receivables *were taken over by the vendors at the end of six months. Collection from* trade receivables *were : January, ₹ 30,000; February, ₹ 15,000; March, ₹ 10,000; April, ₹ 5,000; May, 5,000, June Nil.*

Summarised Balance Sheet of M/s X, Y, Z as on 31st December, 2014

Liabilities	*₹*	*₹*	*Assets*	*₹*
Capital Accounts of Partners:			*Land & Building*	*25,000*
X	*75,000*		*Machinery*	*1,50,000*
Y	*60,000*		*Inventory*	*60,000*
Z	*40,000*	*1,75,000*	*Trade receivables*	*75,000*
General reserve		*80,000*	*Cash*	*5,000*
Trade payables		*56,000*		
Bank overdraft		*4,000*		
		3,15,000		*3,15,000*

Solution

Purchase consideration payable:

		₹
Total of Assets		3,15,000
Add: Amount of Goodwill		20,000
		3,35,000
Less: Assets not taken over		
Cash balance	5,000	
Book debts	75,000	(80,000)
		2,55,000

Vendors Trade Receivables' (Debtors) Account

2015		₹	*2015*		₹
Jan. 1	To Balance of trade receivables taken over for collection	75,000	Jan.31	By Cash (Amount collected)	30,000
			Feb 28	By Cash (Amount collected)	15,000
			Mar. 31	By Cash (Amount collected)	10,000
			Apr. 30	By Cash (Amount collected)	5,000
			May 31	By Cash (Amount collected)	5,000
			June 30	By Balance transferred to Debtors' Suspense Account	10,000
		75,000			75,000

Trade Receivables' Suspense Account

2015		₹	*2015*		₹
Jan. 31	To Amount transferred to Vendors' Collection A/c	28,500	Jan. 1	By Balance of vendors' debtors taken over for collection	75,000
	To Commission A/c	1,500			
Feb. 28	To Amount transferred to Vendor's Collection A/c	14,250			
	To Commission A/c	750			
Mar. 31	To Amount transferred to Vendors' Collection A/c	9,500			
	To Commission A/c	500			
Apr. 30	To Amount transferred to	4,750			

	Vendors' Collection A/c				
	To Commission A/c	250			
May. 31	To Amount transferred to Vendors' Collection A/c	4,750			
	To Commission A/c	250			
June 30	To Amount transferred from Vendors' Debtors A/c	10,000			
		75,000			75,000

Trade Receivables' Suspense Account

2015		₹	*2015*		₹
Jan. 1	To Amount recoverable from vendors in respect of liabilities taken over	56,000	Jan. 31	By Vendors' Collection A/c	28,500
			Feb. 28	By Vendors' Collection A/c	14,250
			Mar. 31	By Vendors' Collection A/c	9,500
			Apr. 30	By Vendors' Collection A/c	3,750
		56,000			56,000

Vendors' Trade Payables (Creditors) Account

2015		₹	*2015*		₹
Jan. 31	To Cash	28,500	Jan. 1	By Amount payable on behalf of vendors	56,000
Feb. 28	To Cash	14,250			
Mar. 31	To Cash	9,500			
Apr. 30	To Cash	3,750			
		56,000			56,000

Vendors' Collection Account

2015		₹	*2015*		₹
Jan. 31	To Amount transferred to Creditors' Suspense A/c	28,500	Jan. 31	By Amount transferred from Debtors' Suspense A/c	28,500
Feb. 28	To Amount transferred to				
Feb. 28	To Creditors' Suspense A/c	14,250	Feb. 28	By Amount transferred from Debtors' Suspense A/c	14,250
Mar. 31	To Amount transferred to Creditors' Suspense A/c	9,500			
Apr. 30	To Amount transferred to Creditors' Suspense A/c	3,750	Mar. 31	By Amount transferred from Debtors' Suspense A/c	9,500

June 30	To	Cash (amt. paid to vendors)	5,750	Apr. 30	By	Amount transferred from Debtors' Suspense A/c	4,750
				May 31	By	Amount transferred from Debtors' Suspense A/c	4,750
			61,750				61,750

Summary

- Profit or loss of a business for the period prior to the date the company came into existence is referred to as Pre-Incorporation Profits or Losses.
- Generally there are two methods of computing Profit & Loss prior to Incorporation:
  i. One is to close off old books and open new books with the assets and liabilities as they existed at the date of incorporation. In this way, automatically the result to that date will be adjusted.
  ii. Other is to split up the profit of the year of the transfer of the business to the company between 'pre' and 'post' incorporation periods. This is done either on the time basis or on the turnover basis or by a method which combines the two.
- A company taking over a running business may also agree to collect its debts as an agent for the vendor and may further undertake to pay the creditor on behalf of the vendors. In such a case, the trade receivables and trade payables of the vendors will be included in the accounts for the company by debit or credit to separate total accounts in the General Ledger to distinguish them from the trade receivables and trade payables of the business and contra entries will be made in corresponding Suspense Accounts. Also details of debtors and creditors balance will be kept in separate ledger.
- The vendor is treated as a creditor for the cash received by the purchasing company in respect of the debts due to the vendor, just as if he has himself collected cash from his debtors and remitted the proceeds to the purchasing company.
- The vendor is considered a debtor in respect of cash paid to his creditors by the purchasing company. The balance of the cash collected, less paid, will represent the amount due to or by the vendor, arising from debtors and creditors balances which have been taken over, subject to any collection expenses.
- The balance in the suspense accounts will be always equal to the amount of debtors and creditors taken over remaining unadjusted at any time.